Supreme Court, U.S.
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No. 95-2080

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

VERONICA ZUCKER, individually and on behalf of a class of others similarly situated,

Petitioner,

vs.

ALAN G. QUASHA; JACK E. ROSENFELD; RALPH DESTINO; J. DAVID HACKMAN, S. LEE KLING, THEODORE H. KRUTT SCHNITT, JEFFREY LAIKIND, ELIZABETH VALK LONG, EDMUND R. MANWELL, GERALDINE STUTZ, ROBERT F. RIGHT, WAYNE P. GARTEN, HANOVER DIRECT INC., SUN LIFE INSURANCE COMPANY OF AMERICA; MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., ALEX BROWN & SONS, INC., individually and on behalf of a class of underwriters similarly situated,

Respondents.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITIONER'S REPLY BRIEF

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INTRODUCTION

Certiorari is clearly warranted in this case, and nothing in Respondents' opposition suggests otherwise.

REASONS FOR GRANTING THE WRIT

I. THERE IS A CONFLICT BETWEEN THE CIRCUITS REGARDING THE NECESSITY TO DISCLOSE ADVERSE FINANCIAL RESULTS FROM THE CURRENT, AS YET INCOMPLETE, FISCAL PERIOD

Respondents raise two arguments in opposition to certiorari. Neither justifies denial of the petition.

A. *Zucker v. Quasha*, 891 F. Supp. 1010 (D.N.J. 1995), *aff'd* 82 F.3d 408 (3d Cir. 1996) and *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir. 1996), State Entirely Inconsistent and Opposing Rules Regarding Prospectus Disclosure of Adverse Financial Results From the Current As Yet Incomplete Fiscal Period.

The District Court held in *Zucker*: "Regardless of whether a public offering occurs seventeen days or only two days before the close of a fiscal quarter, data concerning a quarter that is in progress is necessarily incomplete. As a result, *HDI was incapable of making anything more than projections* regarding return rates for the first quarter of 1994 on March 30, when its Prospectus and Registration Statement became effective." *Zucker* at 1016 (emphasis added).

Since projections need not be disclosed in a Registration Statement, the import of the District Court's holding is clearly that an issuer of securities need never disclose adverse financial information for a fiscal period not complete when the Registration Statement becomes effective.

The First Circuit's ruling disagrees. The First Circuit held that:

> the ability of market observers to evaluate a company depends upon the information publicly available to them. If the issuer is in possession of nonpublic information indicating that the quarter in progress at the time of the public offering will be an extreme departure from the range of results which could be anticipated based on currently available information, it is consistent with the basic statutory policies favoring disclosure to require inclusion of that information in the registration statement.

Shaw at 1210.

B. If the *Zucker* Court Had Applied the Rule in *Shaw*, It Could Not Have Granted Defendants' Rule 12(b)(6) Motion To Dismiss.

In *Shaw*, the prospectus in question was filed 11 days prior to the end of the quarter in progress. The results for that quarter turned out to be the product of more than a minor business fluctuation. The plaintiffs alleged that the defendant, Digital Equipment Corp., by March 21, 1994, was in possession of information about the company's quarter-to-date performance indicating some substantial likelihood that the quarter would turn out to be an extreme departure from publicly known trends and uncertainties. The First Circuit held that it could not conclude as a matter of law and at this early stage of the litigation that such information was not subject to mandatory disclosure under the rubric of "material changes" in Item 11(a) of Form S-3. *Shaw* at 1211.

In HDI, which also conducted its public offering pursuant to a registration statement on SEC Form S-3, the prospectus in question became effective less than three days before the close of the fiscal quarter. *Zucker* at 1012, 1015. The results for that quarter turned out to be the product of more than a minor business fluctuation. The plaintiffs' alleged that

information regarding increased rate of returns must have been available to senior management by the effective date and that HDI was obligated to disclose it. *Id* at 1015. The District Court held that the existence of such an obligation is inconsistent with both *Renz v. Schreiber*, 832 F. Supp. 766, 781 (D.N.J. 1993), and the Ninth Circuit's decision in *In re Worlds of Wonder Securities Litigation*, 35 F.3d 1407, 1418-1419 (9th Cir. 1994). *Zucker* at 1015. The District Court held that as a matter of law, "regardless of whether a public offering occurs seventeen or only two days before the close of the quarter, data concerning a quarter that is in progress is necessarily incomplete." *Id.* at 1016.[1] If the District Court had applied the holding of the First Circuit then the District Court would have found, as the *Shaw* Court found, that it was for the trier of fact to determine whether the registration statement representations on the subject of returns were rendered misleading by the omission of adverse facts known on the effective date.

C. Responses to Respondents' Assertions

Respondents contend that the decision in *Shaw* turned on the requirements of SEC Rule 415(a). (Respondents Br. at 3). However, even a cursory reading of *Shaw* would indicate that the First Circuit based its ruling on the obligations that attend the preparation of a registration statement and prospectus. *See Shaw*, 82 F. 3d at 1202-1211. *See Glassman v. Computervision*, 1996 U.S. App. LEXIS 18765, *17 (1st Cir. July 31, 1996). The First Circuit held only that the need for prompt and continuous disclosure is "particularly keen" when a corporation issues stock pursuant to a shelf registration statement. *Shaw* at 1208.

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[1] This quote highlights petitioner's contention (Petition at 7, fn. 1) that the First Circuit mischaracterized the holding in *Zucker* as dismissing the complaint based on alleged nondisclosure in a March 31 registration statement of information relating to results of period ending July 2. *See Shaw*, 82 F.3d at 1211 and *See* Respondents' Brief at 7.

Respondents contend that Petitioner has failed to identify any compiled information relating to return rates that existed during the first quarter of 1994. (Respondents Br. at 10). However, in *Shaw*, the First Circuit accepted on a motion to dismiss the complaint's allegations that the defendant had in its possession as of the offering date nonpublic information concerning the company's ongoing quarter-to-date performance. *Shaw* at 1207. Similarly, the District Court should have accepted on defendants' motion to dismiss petitioner's allegations that HDI had information regarding increased rate of returns and that HDI was obligated to disclose this information. *Zucker* at 1015.

Respondents contrast the "disastrous" results and the "extreme departure from publicly known trends" at issue in *Shaw* with the information which Petitioner claims was subject to mandatory disclosure. (Respondents Br. at 10). However, in *Zucker* Petitioner claims that HDI experienced a *15%* increase in returns compared to the first quarter in 1993 (an increase from 13% of gross shipments in the first quarter of 1993 to 15% of gross shipments in 1994). *Zucker* at 1015. In HDI's 10-Q for the quarter ending on April 2, 1994, the issuer itself stated that "Revenues were negatively impacted by an increase in customer returns to approximately 15% of shipped sales in the first quarter of 1994 from approximately 13% for the same period in 1993." And it is clear from both the first quarter and second quarter Form 10-Q reports that unquestionably material declines in the issuer's profitability were caused in part by the increased returns.

CONCLUSION

The petition for writ of certiorari should be granted.

Dated: August 29, 1996

Respectfully submitted,

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